

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Kalkaska County Hospital Authority	County Kalkaska
Audit Date 6/30/05	Opinion Date 8/16/05	Date Accountant Report Submitted to State: 12/29/06	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

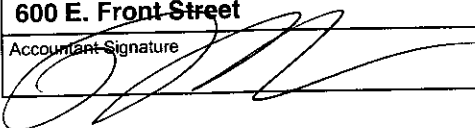
We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ Yes ☒ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☐ Yes ☒ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) Plante & Moran, PLLC			
Street Address 600 E. Front Street	City Traverse City	State MI	ZIP 49686
Accountant Signature 		Date 12-29-06	

Kalkaska County Hospital Authority

Financial Report
June 30, 2005

Kalkaska County Hospital Authority

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Independent Auditor's Report

To the Board of Directors
Kalkaska County Hospital Authority

We have audited the accompanying statement of net assets of Kalkaska County Hospital Authority as of June 30, 2005 and 2004 and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kalkaska County Hospital Authority at June 30, 2005 and 2004 and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements do not present a management's discussion and analysis, which would be an analysis of the financial performance for the year. The Governmental Accounting Standards Board has determined that this analysis is necessary to supplement, although not required to be a part of, the basic financial statements.

Plante & Moran, PLLC

August 16, 2005



A worldwide association of independent accounting firms

Kalkaska County Hospital Authority

Statement of Net Assets

	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Assets		
Current Assets		
Cash and cash equivalents (Note 2)	\$ 2,451,361	\$ 2,159,678
Accounts receivable (Note 3)	1,153,170	861,647
Estimated third-party payor settlements (Note 4)	765,302	368,600
Prepaid expenses and other	297,266	240,712
Total current assets	4,667,099	3,630,637
Assets Limited as to Use	2,286,933	3,388,753
Property and Equipment (Note 6)	12,682,957	11,941,393
Deferred Charges	11,036	17,342
Total assets	<u><u>\$ 19,648,025</u></u>	<u><u>\$ 18,978,125</u></u>
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 7)	\$ 700,000	\$ 700,000
Accounts payable	893,776	660,274
Estimated third-party payor settlements (Note 4)	312,750	134,146
Accrued liabilities and other	877,199	995,345
Total current liabilities	2,783,725	2,489,765
Long-term Debt (Note 7)	750,000	1,450,000
Total liabilities	3,533,725	3,939,765
Net Assets		
Invested in capital assets - Net of related debt	11,232,957	9,791,393
Unrestricted	4,881,343	5,246,967
Total net assets	16,114,300	15,038,360
Total liabilities and net assets	<u><u>\$ 19,648,025</u></u>	<u><u>\$ 18,978,125</u></u>

Kalkaska County Hospital Authority

Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended	
	June 30, 2005	June 30, 2004
Operating Revenues		
Net patient service revenue	\$ 15,106,477	\$ 14,163,255
Other	601,281	593,527
Proportionate share revenue	171,688	201,338
Total operating revenues	15,879,446	14,958,120
Operating Expenses		
Salaries and wages	7,035,464	6,735,264
Employee benefits and payroll taxes	2,506,960	2,278,314
Medical supplies and drugs	1,675,056	1,566,482
Professional services and consultant fees	367,378	372,069
Purchased services	2,055,867	1,847,490
Insurance	172,040	195,221
Utilities	418,222	366,311
Repairs and maintenance	174,042	119,751
Depreciation and amortization	1,077,277	990,145
Other	399,777	262,600
Total operating expenses	15,882,083	14,733,647
Operating Income (Loss)	(2,637)	224,473
Other Income (Expense)		
Investment income	117,683	106,504
Contributions	9,735	6,286
Interest on capital assets - Related debt	(101,431)	(131,793)
Tax levy revenue (Note 5)	1,052,590	997,470
Total other income	1,078,577	978,467
Increase in Net Assets	1,075,940	1,202,940
Net Assets - Beginning of year	15,038,360	13,835,420
Net Assets - End of year	<u>\$ 16,114,300</u>	<u>\$ 15,038,360</u>

Kalkaska County Hospital Authority

Statement of Cash Flows

	Year Ended	
	June 30, 2005	June 30, 2004
Cash Flows from Operating and Nonoperating Activities		
Cash received from patients and third-party payors	\$ 14,768,738	\$ 13,647,207
Cash payments to suppliers for services and goods	(14,746,684)	(12,973,190)
Other receipts from operations	601,281	593,527
Net cash provided by operating activities	623,335	1,267,544
Cash Flows from Noncapital Financing Activities -		
Contributions	9,735	6,286
Cash Flows from Investing Activities		
Investment income	118,183	106,504
Purchase of assets limited as to use	(79,768)	(1,085,305)
Proceeds from sales and maturities of assets limited as to use	1,181,088	532,380
Net cash provided by (used in) investing activities	1,219,503	(446,421)
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(1,818,841)	(809,809)
Proceeds from county tax levy	1,053,076	956,846
Interest paid on long-term debt	(95,125)	(125,486)
Principal payments on notes payable	(700,000)	(650,842)
Net cash used in capital and related financing activities	(1,560,890)	(629,291)
Net Increase in Cash and Cash Equivalents	291,683	198,118
Cash and Cash Equivalents - Beginning of year	2,159,678	1,961,560
Cash and Cash Equivalents - End of year	<u>\$ 2,451,361</u>	<u>\$ 2,159,678</u>

Kalkaska County Hospital Authority

Statement of Cash Flows (Continued)

A reconciliation of operating income (loss) to net cash from operating activities is as follows:

	Year Ended	
	June 30, 2005	June 30, 2004
Cash Flows from Operating Activities		
Operating income (loss)	\$ (2,637)	\$ 224,473
Adjustments to reconcile operating income (loss) to net cash from operating activities:		
Depreciation	1,077,277	990,145
Provision for bad debts	572,337	463,108
(Increase) decrease in assets:		
Patient accounts receivable	(863,666)	4,048
Third-party settlement receivables	(374,852)	(339,854)
Other current assets	(56,554)	42,121
Increase (decrease) in liabilities:		
Increase (decrease) in accounts payable	233,502	217,054
Increase (decrease) in other accrued expenses	(118,826)	48,029
Increase (decrease) in third-party settlement payables	156,754	(381,580)
Net cash provided by operating activities	<u>\$ 623,335</u>	<u>\$ 1,267,544</u>

Kalkaska County Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note I - Nature of Business and Significant Accounting Policies

Reporting Entity and Corporate Structure - Kalkaska County Hospital Authority (the "Hospital"), d/b/a Kalkaska Memorial Health Center, is located in Kalkaska, Michigan and provides inpatient, outpatient, and long-term care services primarily to the citizens of Kalkaska County, Michigan. The Hospital is organized as a governmental unit in accordance with the Joint Hospital Authority Act 47 of the Michigan Public Acts of 1984. Accordingly, no income tax provision has been recorded in the financial statements. The Hospital's financial statements are prepared on the accrual basis of accounting.

Basis of Presentation - The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital follows the "business-type" activities reporting requirements of GASB Statement No. 34, which provide a comprehensive look at the Hospital's financial activities. No component units are required to be reported in the Hospital's financial statements. The Hospital has elected not to apply provisions of relevant Financial Accounting Standard Board Statements.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates.

Cash and Cash Equivalents - Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less.

Assets Limited as to Use - Assets limited as to use include assets designated by the Hospital's board to provide for future replacement of facilities and equipment.

Property and Equipment - Property and equipment are stated at cost. Depreciation is computed using straight-line methods over the estimated useful lives of the assets.

Deferred Charges - Deferred charges represent legal, consulting, and financial costs associated with debt financing (see Note 7) and are being amortized over the terms of the debt agreement.

Classification of Net Assets - Net assets of the Hospital are classified into two components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt.

Kalkaska County Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note I - Nature of Business and Significant Accounting Policies (Continued)

Compensated Absences - Paid time off is charged to operations when earned. Unused and earned benefits are recorded as a current liability in the financial statements.

Retirement Plan - The Hospital sponsors a 401(k) profit-sharing plan covering substantially all its employees.

Net Patient Service Revenue - The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

Operating Revenue and Expenses - The Hospital's statement of revenue, expenses, and changes in net assets distinguishes between operating and nonoperating revenue and expenses. Operating revenue results from exchange transactions associated with providing health care services, the Hospital's principal activity. Nonexchange revenue, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenue. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Professional and Other Liability Insurance - The Hospital accrues an estimate of the ultimate expense, including litigation and settlement expense, net of applicable reinsurance coverage, for incidents of potential improper professional service and other liability claims occurring during the year as well as for those claims that have not been reported at year end.

Kalkaska County Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care amounts to less than 1 percent of patients served.

Proportionate Share Reimbursement Program (Intergovernmental Transfers) - The Hospital participates in the Proportionate Share Reimbursement Program sponsored by the State of Michigan. This resulted in revenue of \$171,688 and \$201,338 during the years ended June 30, 2005 and 2004, respectively.

Note 2 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The Hospital has designated three banks for the deposit of its funds. The Hospital's deposit policies are in accordance with statutory authority.

The Hospital's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The government does not have a deposit policy for custodial credit risk. At year end, the Hospital had \$1,962,650 of bank deposits (certificates of deposit, checking accounts, and savings accounts) that were uninsured and uncollateralized. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Kalkaska County Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 2 - Deposits and Investments (Continued)

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital's investment policy does not restrict investment maturities, other than commercial paper which can only be purchased with a 270-day maturity. At year end, the average maturities of investments are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Weighted Average Maturity</u>
Sweep account	\$ 1,460,662	3 months

Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Hospital has no investment policy that would further limit its investment choices.

<u>Investment</u>	<u>Fair Value</u>	<u>Rating</u>	<u>Rating Organization</u>
Sweep account	\$ 1,460,662	A-	Fitch

Note 3 - Accounts Receivable

The details of patient accounts receivable are set forth below:

	<u>2005</u>	<u>2004</u>
Patient accounts receivable	\$ 2,685,638	\$ 2,157,793
Less:		
Allowance for uncollectible accounts	174,301	145,891
Allowance for contractual adjustments	1,393,916	1,205,049
Net patient accounts receivable	1,117,421	806,853
Other	35,749	54,794
Total accounts receivable	<u>\$ 1,153,170</u>	<u>\$ 861,647</u>

Kalkaska County Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 3 - Accounts Receivable (Continued)

The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	2005 (%)	2004 (%)
Medicare	32	31
Blue Cross/Blue Shield of Michigan	16	16
Medicaid	28	30
Commercial insurance and HMOs	15	15
Self-pay	9	8
Total	100	100

Note 4 - Cost Report Settlements

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Approximately 84 percent of the Hospital's net patient service revenue is received from the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - The Hospital is designated as a critical access hospital under Medicare regulations. Under this designation, the Hospital receives 101 percent of reasonable, cost-based reimbursement for inpatient and outpatient services provided to Medicare beneficiaries. Long-term care services are reimbursed at prospectively determined rates per patient day.
- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. Outpatient services are reimbursed on an established fee-for-service methodology. Long-term care services are reimbursed at established per diem rates plus allowable cost for ancillary services.
- **Blue Cross/Blue Shield of Michigan** - Services rendered to Blue Cross/Blue Shield subscribers are reimbursed at controlled charges.

Advances and cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying financial statements.

Kalkaska County Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 5 - Tax Levies

The Hospital is operated under the Joint Hospital Authority Act 47 (the "Act") of the Michigan Public Acts of 1984. Under this Act, by April 1 of each year, the Hospital board is required to prepare a balanced budget for the ensuing year. The budget is to ascertain what amount, if any, is to be raised by taxation from the townships belonging to the authority to meet their respective shares of the expenses over revenue. Upon certification by the Hospital board, the townships are required to pay their share from the funds they have available or from the proceeds of a tax levy. They are authorized to levy up to .4 mill, but levied .01 mill and .1 mill for the years ended June 30, 2005 and 2004, respectively. The required sums are due and payable 120 days after December 1, the date on which local taxes become due and payable in the townships.

In addition to the levy described above, the Act allows a levy up to 2 mills for not more than 10 years for capital improvements when approved at a general or special election in the townships belonging to the authority.

In May 1997, the electorate approved a 1.7 mill levy for 10 years. The proceeds from the levy are to be used to retire unlimited tax general obligation bonds (see Note 7). The ordinance authorizing the sale of the bonds requires the proceeds of the 1.7 mill tax levy to be deposited in a bond and interest redemption fund. The amount in excess of the debt service payments must be deposited in a capital improvement fund and used for capital improvement purposes.

Tax levy revenue is composed of the following:

	2005	2004
Operating tax levy	\$ 5,466	\$ 46,149
Bond retirement 1.7 mill tax levy	1,047,124	951,321
Total	<u>\$ 1,052,590</u>	<u>\$ 997,470</u>

Kalkaska County Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 6 - Property and Equipment

Cost of capital assets and related depreciable lives for June 30, 2005 are summarized below:

	2004	Additions	Transfers	Retirements	2005	Depreciable Life - Years
Land and land improvements	\$ 908,748	\$ -	\$ -	\$ (18,161)	\$ 890,587	5-25
Building	14,062,836	12,341	836,194	(70,016)	14,841,355	15-40
Equipment	5,069,712	106,466	1,104,390	(541,786)	5,738,782	3-20
Construction in progress	241,050	1,700,034	(1,940,584)	-	500	
Total	20,282,346	1,818,841	-	(629,963)	21,471,224	
Less accumulated depreciation:						
Land and land improvements	240,040	32,261	-	(18,161)	254,140	
Building	4,577,666	537,613	-	(70,016)	5,045,263	
Equipment	3,523,247	507,403	-	(541,786)	3,488,864	
Total	8,340,953	1,077,277	-	(629,963)	8,788,267	
Net carrying amount	\$11,941,393	\$ 741,564	\$ -	\$ -	\$12,682,957	

Kalkaska County Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 6 - Property and Equipment (Continued)

Cost of capital assets and related depreciable lives for June 30, 2004 are summarized below:

	2003	Additions	Transfers	Retirements	2004	Depreciable Life - Years
Land and land improvements	\$ 832,817	\$ -	\$ 75,931	\$ -	\$ 908,748	5-25
Building	13,061,765	-	1,001,071	-	14,062,836	15-40
Equipment	4,905,084	85,101	79,527	-	5,069,712	3-20
Construction in progress	672,871	724,708	(1,156,529)	-	241,050	
Total	19,472,537	809,809	-	-	20,282,346	
Less accumulated depreciation:						
Land and land improvements	208,623	31,417	-	-	240,040	
Building	4,055,970	521,696	-	-	4,577,666	
Equipment	3,086,215	437,032	-	-	3,523,247	
Total	7,350,808	990,145	-	-	8,340,953	
Net carrying amount	\$12,121,729	\$ (180,336)	\$ -	\$ -	\$11,941,393	

Kalkaska County Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 7 - Long-term Debt

Long-term liability activity for the year ended June 30, 2005 was as follows:

	<u>2004</u>	<u>Current Year Additions</u>	<u>Current Year Reductions</u>	<u>2005</u>	<u>Amounts Due Within One Year</u>
Series 1998 Bonds	<u>\$2,150,000</u>	<u>\$ -</u>	<u>\$ (700,000)</u>	<u>\$1,450,000</u>	<u>\$ 700,000</u>

Long-term liability activity for the year ended June 30, 2004 was as follows:

	<u>2003</u>	<u>Current Year Additions</u>	<u>Current Year Reductions</u>	<u>2004</u>	<u>Amounts Due Within One Year</u>
Series 1998 Bonds	<u>\$2,800,000</u>	<u>-</u>	<u>\$ (650,000)</u>	<u>\$2,150,000</u>	<u>\$ 700,000</u>
Other	<u>842</u>	<u>-</u>	<u>(842)</u>	<u>-</u>	<u>-</u>
Total	<u>\$2,800,842</u>	<u>\$ -</u>	<u>\$ (650,842)</u>	<u>\$2,150,000</u>	<u>\$ 700,000</u>

The Kalkaska County Hospital Authority, Series 1998 unlimited tax general obligation bonds are payable solely from a \$1.7 mill tax levy and the net revenue of the Hospital. The bonds mature annually in amounts ranging from \$700,000 to \$750,000 through April 1, 2007 and bear interest at rates ranging from 4.8 percent to 4.85 percent.

The following is a schedule by years of bond principal and interest as of June 30, 2005:

<u>Years Ending June 30</u>	<u>Long-term Debt</u>	
	<u>Principal</u>	<u>Interest</u>
2006	<u>\$ 700,000</u>	<u>\$ 69,975</u>
2007	<u>750,000</u>	<u>36,375</u>
Total payments	<u>\$ 1,450,000</u>	<u>\$ 106,350</u>

Note 8 - Retirement Plan

The Hospital maintains a Section 401(k) plan covering employees having worked more than 1,000 hours per year for two consecutive years. Under the terms of the plan, the Hospital will contribute 1 percent of employees' compensation and will match employee contributions on a sliding scale up to 4 percent of employee earnings. Total retirement expense was \$269,026 and \$265,453 for the years ended June 30, 2005 and 2004, respectively.

Kalkaska County Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 9 - Risk Management

The Hospital is exposed to various risks of loss related to property loss, errors and omissions, employee injuries (worker's compensation), and professional liability claims, as well as medical benefits provided to employees. The Hospital has purchased commercial insurance for the above claims. Settled claims relating to commercial insurance have not exceeded the amount of insurance in any of the past three years.

The Hospital is insured against medical malpractice claims under a claims-based policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital must pay a deductible toward the costs of litigating or settling any unasserted claims. In addition, the Hospital bears the risk of ultimate costs of any individual claim exceeding the policy limits for claims asserted in the policy year.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on the occurrences during the claims-made term, but reported subsequently, will be uninsured.

The Hospital is not aware of any medical malpractice claims, either asserted or unasserted, that would exceed the policy limits. No claims have been settled during the past three years that have exceeded policy coverage limits. The cost of this insurance policy represents the Hospital's cost for such claims for the year, and it has been charged to operations as a current expense.

Note 10 - Administrative, Laundry, and Laboratory Service Agreements

The Hospital has entered into agreements with Munson Medical Center and Munson Healthcare and Subsidiaries to receive administrative services including an administrator, accounting services, physical therapy, certain laboratory tests, and other miscellaneous services. Charges for these services to the Hospital amounted to \$1,363,278 and \$1,261,614 for the years ended June 30, 2005 and 2004, respectively, of which \$277,445 and \$161,455, respectively, is included in accounts payable.

August 16, 2005

Board of Trustees
Kalkaska County Hospital Authority

In planning and performing our audit of the financial statements of Kalkaska County Hospital Authority for the year ended June 30, 2005, we considered the Hospital's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. The consideration we gave to the internal control structure was not sufficient for us to provide any form of assurance on it. However, we noted certain matters involving the internal control structure and its operation where we feel opportunities for improvement exist, as well as some additional areas for Board consideration.

This report contains our observations, comments, and other items we feel warrant your consideration. All items are presented for your consideration on attachments as outlined below:

<u>TITLE</u>	<u>EXHIBIT</u>
GASB 40 - Deposit and Investment Risk Disclosures	A
Highlights of the OIG's 2005 Work Plan	B
Corporate Compliance Update	C
Developing a HIPAA Contingency Plan	D

We appreciate the opportunity to be of service to the Hospital. The cooperation extended to us by your staff throughout the audit was greatly appreciated. Should you wish to discuss any of the items included in this report, we would be happy to do so.

Sincerely,

PLANTE & MORAN, PLLC



Michael A. Baker, CPA
Partner

Enclosures

Kalkaska County Hospital Authority
Exhibit A
GASB 40 – Deposit and Investment Risk Disclosures

The Governmental Accounting Standards Board (GASB) recently issued GASB Statement No. 40 - Deposit and Investment Risk Disclosures, which is effective for all financial statement periods beginning after June 15, 2004. The Hospital has adopted this Statement for the year ended June 30, 2005. The deposits and investments of governmental entities are exposed to inherent risks that have the potential to result in losses. This Statement is designed to inform financial statement users about deposit and investment risks that could affect the entity's ability to provide services and meet its obligations as they become due. It requires expanded disclosures in the financial statements on these risks including the entity's policies for addressing the risks.

The five common deposit and investment risks addressed in this Statement are defined as follows:

Custodial Credit Risk – The risk that in the event of a failure of a depository financial institution, the entity will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

Interest Rate Risk – The risk that changes in interest rates will adversely affect the fair value of an investment or deposit.

Credit Risk – The risk that an issuer or other counterparty to an investment will not fulfill its obligations.

Concentration of Credit Risk – The risk of loss attributed to the magnitude of the entity's investment in a single issuer.

Foreign Currency Risk – The risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit.

Kalkaska County Hospital Authority principally holds cash and deposits, which are subject to custodial credit risk. The Hospital also holds a sweep account, which is subject to custodial credit risk, interest rate risk, and credit risk. We encourage the Hospital to review its investment policies to assess and address any applicable risks.

Kalkaska County Hospital Authority
Exhibit B
Highlights of the OIG's 2005 Work Plan

The 2005 Work Plan issued by the Office of the Inspector General (OIG) identifies projects that have evolved in response to new issues and the shifting priorities of Congress. The OIG spends significant resources in the investigation of fraud and misconduct committed against the Medicare and Medicaid programs.

Highlights from the OIG's 2005 Work Plan include, but are not limited to:

Critical Access Hospitals – OIG will review hospital cost reports to examine the administrative and other costs incurred by critical access hospitals for inpatient and outpatient services for time periods both prior and subsequent to their conversion to critical access hospital status.

Rebates Paid to Hospitals – OIG will determine whether hospitals are properly identifying purchase credits as a separate line item in their Medicare cost reports. This will be done through visiting several large vendors and determining the amount of rebates paid to hospitals in a given year, and then examining a sample of costs reports to determine if the rebates were properly credited.

Outpatient Cardiac Rehab Services – OIG will determine whether cardiac rehab services provided by hospital outpatient departments meet Medicare coverage requirements. Medicare covers such rehab under the "incident-to" a physician's professional services benefit, which requires that the services of non-physician personnel be furnished under the physician's direct supervision.

Lifetime Reserve Days – OIG will determine how hospitals comply with the current requirement to notify Medicare beneficiaries about the use of lifetime reserve days and also assess the appropriateness and feasibility of providing an additional notification prior to a beneficiary's exhaustion of them. Medicare beneficiaries are entitled to an unlimited number of 90-day episodes of care. They may also extend their inpatient benefit by up to a lifetime total of 60 days. These are called lifetime reserve days; they are not renewable.

Physicians - Coding of Evaluation and Management (E&M) Services – OIG will examine patterns of physician coding of E&M services and determine whether these services were coded accurately. In 2003, Medicare allowed over \$29 billion for E&M services. In prior work, the OIG has found that a significant portion of certain categories of these services were billed with incorrect codes resulting in large overpayments.

Physicians - Use of Modifier 25 – In general, a provider should not bill E&M codes on the same day as a procedure or other service unless the E&M service is a significant, separately identifiable service from such procedure or service. OIG will determine whether providers use modifier 25 appropriately.

Kalkaska County Hospital Authority
Exhibit B
Highlights of the OIG's 2005 Work Plan (Continued)

Long-Term Care - Resident Assessment and Care Planning – OIG will examine the type, frequency, and severity of deficiencies related to assessment and care planning for nursing home residents.

Long-Term Care - Imaging and Laboratory Services – This study will determine the extent and nature of any medically unnecessary or excessive billing for imaging and laboratory services provided to nursing home residents. Medicare pays more than \$200 million a year for such services.

Durable Medical Equipment - Medical Necessity – This review will determine the appropriateness of Medicare payments for certain items of durable medical equipment, such as power wheelchairs and therapeutic footwear. OIG will assess whether the supplier's documentation supports the claim, whether the item was medically necessary, and whether the beneficiary actually received the item.

Kalkaska County Hospital Authority
Exhibit C
Corporate Compliance Update

The Office of Inspector General (OIG) has issued its Supplemental Compliance Program Guidance for Hospitals (CPG). The full text of this notice is contained in Federal Register Notice 70 FR 4858 dated January 31, 2005. Through this notice, the OIG is supplementing its prior compliance program guidance for hospitals issued in 1998. The supplemental CPG contains new compliance recommendations and an expanded discussion of risk areas, taking into account recent changes to hospital payment systems and regulations, evolving industry practices, current enforcement priorities, and lessons learned in the area of corporate compliance. The supplemental CPG provides voluntary guidelines to assist hospitals and hospital systems in identifying significant risk areas and in evaluating and, as necessary, refining ongoing compliance efforts.

Realizing the diversity of the hospital industry, the OIG's CPG does not provide a "one-size-fits-all" guidance, but rather encourages hospitals to identify and focus their compliance plans and efforts on areas of potential concern and risk that are the most relevant to their individual Hospitals and to the delivery of health care in general.

The OIG explained that hospitals may gain important information by voluntarily implementing a compliance program that includes:

1. A demonstration of the hospital's commitment to honest and responsible corporate conduct.
2. A plan of increasing the likelihood of preventing, identifying and correcting unlawful and unethical behavior at an early stage.
3. A method of encouraging employees to report potential problems to allow for appropriate internal inquiry and corrective action.
4. A plan that, through early detection and reporting, minimizes any financial loss to government and taxpayers, as well as any corresponding financial loss to the hospital.

The supplemental CPG also indicates several areas that the OIG considers ripe for fraudulent activity. Outpatient bill coding, due to its complexity with both prospective payment system codes and ambulatory payment classification codes, especially concerns the OIG. Improper coding and billing for "same-day" discharges and readmissions, and improper claims for pass-through drugs, outlier payments, and provider-based services are also new problem areas.

We commend the Hospital on its efforts to support and monitor corporate compliance activities. We do, however, strongly encourage the Hospital to thoroughly review the new Supplemental CPG and incorporate it into the existing plan and activities.

Kalkaska County Hospital Authority
Exhibit D
Developing a HIPAA Contingency Plan

Computer systems are never 100 percent reliable. They can crash, making data difficult, if not impossible, to recover. Under the HIPAA Security Rule, which covered entities must start complying with in April, health care organizations must develop a data backup plan. Health care organizations must establish and implement procedures to create and maintain retrievable exact copies of electronic protected health information (PHI) and backup data on a regular basis. Electronic PHI should not be interpreted as being just electronic medical records, but also includes all patient information maintained on a computerized system, including scheduling, medications, lab results, etc. Hospitals must also establish, and implement as needed, procedures to restore any lost data in the case of any disaster.

HIPAA also requires covered entities to implement an emergency mode operation plan containing procedures that enable them to continue critical business processes that protect the security of electronic PHI. This may be as simple as maintaining paper records until the emergency situation is over. Contingency plans need to be tested and revised regularly. Initially, testing should be done in sections or functional areas and during non-operations hours.

Covered entities also need to review and document the relative importance of all hardware and software applications. For example, if a covered entity uses two applications, one for scheduling and one for accessing certain electronic PHI, it should consider which one is more critical or important to restore first in the event of an emergency. The order of priority will be very important in creating the detailed backup, disaster recovery, and emergency mode operations.

Also crucial is establishing procedures that allow support personnel to get into the facility and restore lost data in the event of an emergency. This will help ensure those needing access in an emergency have access, including any individuals who normally do not have access to the covered entity's electronic information.

The primary objectives of a disaster recovery plan are to protect the Hospital in the event that all or part of its operations and/or computer services are rendered unusable, minimize disruption of operations, and ensure some level of organizational stability and an orderly recovery after a disaster. Moreover, a disaster recovery plan provides a sense of security, minimizes the risk of delays, guarantees the reliability of standby and secondary systems and processes, establishes a standard plan for testing, and minimizes decision making during a disaster.

We recommend that the Hospital review any contingency plans currently in place and ensure that the HIPAA requirements are covered.